

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

In the Matter of

Federal State Board on
Universal Service

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CC Docket Nos. 96-45, 97-160
DA 98-715

PROPOSAL OF GTE

Dated: April 27, 1998

GTE Service Corporation and its affiliated
domestic telephone operating, wireless, and
long distance companies

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SUMMARY

GTE welcomes the Commission's effort to reevaluate the universal service plan it adopted in May of 1997. If the Commission is to carry out its mandate under the Telecommunications Act of 1996 to preserve and protect universal service, then significant changes must be made to that plan.

The Commission has wrestled for the last two years over the development of cost models, and over the choice of benchmarks and other parameters for the calculation of Federal universal service support. GTE submits that it is possible -- and indeed necessary -- to establish relatively clear measures of the minimum amount of support that the Federal plan must provide. These are as follows:

1. The Federal plan must provide support that is sufficient to replace the flow of implicit universal service support that is generated today by interstate access charges.
2. The Federal plan should provide a reasonable amount of support to states, particularly those with high costs and/or low revenues, to help those states replace the implicit support that is generated today by state rates for services such as access, toll, and vertical features.
3. The Federal plan should maintain the support that is provided to non-rural companies by the current high cost fund.

These policy goals provide an objective measure of whether the Federal plan is sufficient; the benchmarks and percentages used to calculate Federal support should be chosen to ensure that the plan provides at least the support required to meet these goals.

GTE proposes that the Commission should establish a sliding scale of benchmarks and percentages for Federal support. A simple example of such a framework would be the two-benchmark approach which has been proposed by US West. However, an additional benchmark (or benchmarks) may be needed to allow the plan to achieve the Commission's policy goals.

The structure and parameters of this framework cannot be chosen in a vacuum. Instead, the parameters should be chosen to ensure that the policy goals listed above are met. The Commission should choose the cost model and inputs it will employ in the calculation *before* it chooses the benchmarks and percentages, so that it can assure itself that the parameters chosen will produce the desired results.

The Act requires that the sum of the universal service support provided by state and interstate mechanisms be sufficient, but it does not specify the proportion of that total that must be provided by the Federal plan. It is therefore reasonable that the Federal plan should include a benchmark which serves as a dividing line between state and Federal responsibility. However, the Commission's framework must be designed to be consistent with its plenary responsibility – which the Commission itself recognizes – to ensure that the overall effect of universal service mechanisms are sufficient. Thus, the Federal benchmark (or benchmarks) should simply represent cost levels at which the Federal plan will intervene to provide support. They should not represent an assumption by the Commission that implicit universal service support, provided today by the rates charged for other services, can or should continue into the future.

The contributions necessary to fund the Federal support amount should be based on the total of carriers' state and interstate retail revenues. Carriers should recover their contributions through a uniform percentage surcharge.

GTE proposes a methodology consistent with the requirements of the Telecommunications Act of 1996 and which meets Congress' express intention to introduce competition into the telecommunications marketplace only while protecting universal service.

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PROPOSAL OF GTE

GTE Service Corporation and its affiliated domestic telephone operating,¹ wireless,² and long distance³ companies (collectively "GTE") respectfully respond to the Common Carrier Bureau's Public Notice DA 98-715 (released April 15, 1998) ("Notice") seeking proposals to revise the methodology for determining universal service support.⁴

¹ GTE Alaska Incorporated, GTE Arkansas Incorporated, GTE California Incorporated, GTE Florida Incorporated, GTE Hawaiian Telephone Company Incorporated, The Micronesian Telecommunications Corporation, GTE Midwest Incorporated, GTE North Incorporated, GTE Northwest Incorporated, GTE South Incorporated, GTE Southwest Incorporated, Contel of Minnesota, Inc., and Contel of the South, Inc.

² GTE Wireless Incorporated.

³ GTE Communications Corporation, Long Distance division.

⁴ GTE's proposal described in these comments, and its intention to comment on other proposals either already identified by the Commission in the Notice or which may be proffered by other parties, in no manner prejudices its positions set forth in its appeals of the Commission's universal service or access charge reform orders. See *Texas Office of Public Utility Counsel v. F.C.C.*, No. 97-60421 (5th Cir.) ("*Texas Ofc. Of Pub. Util. Counsel*"); *Southwestern Bell Tel. Co. v. F.C.C.*, No. 97-2618 (8th Cir.) ("*Southwestern Bell*"). As fully set forth in GTE's briefs before those courts, the Commission's universal service and access charge reform orders should be vacated. Unless the Commission were to vacate these orders and comply with the statutory requirements to eliminate implicit subsidies and establish an explicit and sufficient universal service funding mechanism supported by all telecommunications

This Proposal is divided into two primary parts. Sections II and III outline the requirements of the Act and the regulatory policies which the Federal plan should advance. Sections IV and V set forth the specifics of GTE's proposal.

I. INTRODUCTION.

GTE proposes that the Commission establish a sliding scale of benchmarks and percentages for Federal support. A simple example of such a framework is the two-benchmark approach proposed by US West. However, an additional benchmark may be needed to allow the plan to achieve the Commission's policy goals. A further description of this framework, and a quantification of specific examples, is provided in Section IV.

The structure and parameters of this framework cannot be chosen in a vacuum. There are certain specific tasks which the Federal universal service mechanism must perform if the sum of state and Federal support is to be sufficient, as the Telecommunications Act of 1996⁵ requires. These are as follows:

1. A Federal plan must provide support that is sufficient to replace the flow of implicit universal service support that is generated today by interstate access charges. In addition, in establishing Federal support, the

carriers on a truly equitable and nondiscriminatory basis, the instant proceeding does not and cannot cure the fatal defects its in prior orders.

⁵ The Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (February 8, 1996), *codified beginning at* 47 U.S.C. § 153 *et seq.* (the "1996 Act" or "Act"). All references to "the Act" are to the Communications Act of 1934 as amended by the 1996 Act.

Commission must recognize that reductions in interstate access charges are constrained by the level of Federal universal service support.

2. A Federal plan should provide a reasonable amount of support to states, particularly those with high costs and/or low revenues. Federal support would help those states replace the implicit support that is generated today by state rates for services such as access, toll, and vertical features, and accommodate states that cannot eliminate implicit subsidies and still maintain affordable rates.
3. A Federal plan should maintain the support that is provided to non-rural companies by the current high cost fund.

These elements provide an objective measure of whether the Federal plan is sufficient; the benchmarks and percentages used to calculate Federal support should be selected to ensure that the plan is sufficient, as required by the Act. The Commission should choose the cost model and inputs it will employ in the calculation *before* it chooses the benchmarks and percentages, so that it can assure itself that the parameters chosen will produce the desired results.

In addition, the contributions necessary to fund the Federal support amount should be based on the total of carriers' state, interstate and international retail revenues. Carriers should recover their contributions through a uniform percentage retail surcharge. This proposal is set forth in greater detail below. GTE believes its methodology is consistent with the requirements of the Act and meets Congress'

express intention to introduce competition into the telecommunications marketplace only while protecting universal service.⁶

II. A FEDERAL FUND SHOULD BE SUFFICIENT TO ALLOW ELIMINATION OF SUBSIDIES IMPLICIT IN INTERSTATE RATES

In passing the 1996 Act, Congress sought to introduce competition into the market for local telephone service.⁷ In doing so, Congress recognized that one of the primary challenges it would confront would be to reconcile the advent of competition with the maze of subsidies and social engineering that federal and state regulators have long built into incumbent local exchange carrier ("ILEC") rates to promote universal service.

ILECs have long been required to charge some customers rates well above cost in order to subsidize others. This, Congress recognized, was necessary to ensure that telephone service was affordable for all, including high-cost users in rural and other expensive-to-serve areas. Congress also recognized, however, that when competition is introduced, this system of implicit subsidies is not sustainable and universal service may be threatened. The Commission has described the problem well:

"The 1996 Act removes barriers to entry in the local market, generating competitive pressures that make it difficult for incumbent LECs to maintain access charges above economic cost. . . . [W]here existing rules require an incumbent LEC to set access charges above cost for a high-volume user, a competing provider of exchange access services entering into a

⁶ 47 U.S.C. § 254(b). See also Joint Explanatory Statement of the Committee of Conference, at 128-134.

⁷ See, e.g., Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges, CC Docket Nos. 96-262 *et al.*, First Report and Order, FCC 97-158, 12 FCC Rcd 15982, 15985 (released May 16, 1997) ("Access Reform Order"), at ¶ 1.

market can lease unbundled network elements at cost, or construct new facilities, to circumvent the access charge. In this way, a new entrant might target an incumbent LEC's high volume access customers, for whom access charges are now set at levels significantly above economic cost. As competition develops, incumbent LECs may be forced to lower their access charges or lose market share, in either case jeopardizing the source of revenue that, in the past, has permitted the incumbent LEC to offer service to other customers, particularly those in high-cost areas, at below-cost prices."⁸

Historically, the Commission has required ILECs to use several mechanisms to recover the interstate portion⁹ of their costs and to subsidize their universal service obligations. One mechanism used to recover a portion of local loop costs is the federal subscriber line charge ("SLC"). However, as the Commission has explained, it "limited the amount of the allocated interstate cost of a local loop that is assessed to residential and business customers as a flat monthly charge, because of concerns that allowing the flat charges to rise above the specified limits might cause customers to disconnect their telephone service."¹⁰ Because it cannot Constitutionally leave the remaining

⁸ Access Reform Order, ¶ 32.

⁹ To facilitate a system of joint state and federal regulation, the Act provides for the establishment of a separations process whereby the costs of ILEC equipment are allocated between the intrastate and interstate jurisdictions. Once the costs have been thus allocated, individual state commissions establish rates for intrastate services to recover intrastate costs. The Commission establishes separate rates for interstate access to the local exchange through by which ILECs recover interstate costs. *National Ass'n of Regulatory Utility Commissioners v. F.C.C.*, 737 F.2d 1095, 1105 (D.C. Cir. 1984), *cert. denied*, 469 U.S. 1227 (1985) ("NARUC"); Access Reform Order, ¶¶ 17, 22.

¹⁰ Access Reform Order, ¶ 24.

interstate costs unrecovered, the Commission requires ILECs to recover their remaining interstate costs through the access charges levied on interexchange carriers.¹¹

The net effect and purpose of the Commission's pre-1996 Act access charge regime was to create a system of implicit subsidies to support universal service. As the Commission has explained:

"To the extent [current] rates do not reflect the underlying cost of providing access service, they could be said to embody an implicit subsidy. . . . [A]lthough the cost of the local loop that connects an end user to a telephone company's switch does not vary with usage, the current rate structure rules require incumbent LECs to recover a large portion of these non-traffic-sensitive costs through traffic-sensitive, per-minute charges. These mandatory recovery rules inflate traffic-sensitive usage charges and reduce charges for connection to the network, in essence *creating an implicit support flow from end users that make many interstate long-distance calls to end users that make few or no interstate long-distance calls.*"¹²

This system of implicit subsidies in carriers' rates established by the Commission to support universal service could be sustained only when incumbents were protected from competition. Recognizing the significance of this problem in the transition to a competitive environment, Congress reacted with a straightforward solution intended to

¹¹ See Access Reform Order, ¶ 24 (costs of local loop "not recovered from end users through the flat charge is recovered through a per-minute-of-use charge assessed to long-distance carriers"). There are a number of components of access charges. Under the pre-1996 Act regime, interexchange carriers paid a usage sensitive Carrier Common Line Charge ("CCLC") to LECs for both originating calls and terminating calls. Interexchange carriers also paid a usage sensitive Transport Interconnection Charge ("TIC"), which the Commission has recognized as much as 75 percent of which is, in fact, a contribution to universal service. In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, *First Report and Order*, 11 FCC Rcd 15499, 15865 [¶ 722] (1996) ("Local Competition Order").

¹² Access Reform Order, § 28 (emphasis added).

strengthen universal service by rationalizing its funding and building a support mechanism that could survive, and would not distort, competition in the market for local phone services. Specifically, the 1996 Act requires recrafting of universal service support essentially as a rate-setting exercise designed to reduce current rates which encompass implicit subsidies to competitive levels. Simply stated, in recognizing the erosion of implicit subsidies attendant emerging competition, Congress correctly discerned the competitive necessity to establish cost-based rates while maintaining affordable local service.

In Section 254 of the 1996 Act, Congress charged the Commission with establishing an entirely new federal funding mechanism to support universal service.¹³ Section 254 is an unambiguous mandate to the Commission to establish an *explicit* and *sufficient* universal service fund to replace the current system of implicit subsidies embedded in rates, which all providers of telecommunications services must support on an *equitable* and *nondiscriminatory* basis.

In Section 254, Congress directed the fundamental reshaping of the funding for universal service by requiring: (1) that every provider of telecommunications service, including every new entrant seeking to provide local telephone service, be required to make an "equitable and nondiscriminatory contribution to the preservation and advancement of universal service;"¹⁴ (2) that the Commission, in consultation with a specially-established Federal-State Joint Board, replace the current unsustainable

¹³ See *Competitive Telecommunications Ass'n v. F.C.C.*, 117 F.3d 1068, 1074 (8th Cir. 1997) ("*CompTel*").

¹⁴ 47 U.S.C. § 254(b)(2).

system of implicit subsidies with an entirely new universal service funding mechanism that is both "explicit and sufficient;"¹⁵ and (3) that any telecommunications service provider seeking support from the universal service fund offer the supported services "throughout the service area" for which it seeks universal service funds.¹⁶

In order to fulfill these requirements, a Federal universal service fund must, *at a minimum*, meet the following criteria:

First, implicit subsidies must be eliminated from the mechanisms which provide universal service support. In other words, it is self-defeating – not to mention explicitly contrary to Section 254 – to attempt to recraft universal service without truly beginning at square one; that is, implicit subsidies must be identified and eliminated, and no new implicit subsidies may be created in this process.¹⁷ This means, specifically, that the explicit funding mechanisms of the Federal plan must first recover the subsidies that will

¹⁵ 47 U.S.C. § 254(e). Congress also directed that the Commission act expeditiously — by May 8, 1997 (47 U.S.C. § 254(a)(2)) — to establish the new explicit universal service funding mechanism, so that competition could get underway quickly and fairly, guided by market incentives — a requirement which the Commission expressly failed to fulfill.

¹⁶ 47 U.S.C. § 214(e)(1).

¹⁷ As set forth fully in its brief in *Southwestern Bell*, the Commission's attempt at access reform produces just the opposite results: The creation of new subsidies without the elimination of existing implicit subsidies. Moreover, the Commission's reliance upon a so-called "market-based" approach to drive down access charges is truly perverse for it treats the problem (emerging competition) as the solution.

be lost as competition depresses access charges to market levels.¹⁸ Second, in calculating the costs to provide universal service, the Federal plan must reflect an ILEC's *actual costs* of providing universal service. In other words, the federal plan may not base its calculations on, for example, the costs of operating some hypothetical network. For more than three years, the Commission has unsuccessfully struggled with complex economic cost models that purport to measure the forward-looking cost of deploying a telecommunications network and providing telephone services. The actual costs of the firms that presently provide service and operate networks are a far better, simpler indicator of costs than are the results generated by models sponsored by parties with economic incentives to manipulate the results. Forward-looking models may be useful for the purpose of identifying the relative distribution of costs within an ILEC's serving area; however, they should not become a vehicle for simply inventing a new overall level of cost.

Moreover, the additional requirements imposed by Section 254(h) of the Act — and the funding necessary to fulfill these requirements — are separate from, and in addition to, ILEC costs of providing the existing level of universal service today. In other words, the Federal plan must be sufficient not only to provide discounts to schools, libraries and rural health care providers as required by subsection (h) but, also,

¹⁸ GTE estimates that implicit support from interstate access industry-wide is approximately \$6.3 billion. For GTE alone, this amount is about \$1.17 billion. In addition, the explicit funding mechanisms in the combined federal and state plans must also recover the subsidies now implicit in state switched access, intraATA toll, vertical services and business local which will similarly not exist in cost-based rates. See *generally* USF Order, at ¶¶ 11, 14, 17 (describing the system of implicit cross-subsidies used by states to maintain low basic residential rates)..

to maintain and advance universal service for low-income consumers, rural high-cost areas, and other supported services.¹⁹

Third, broadly speaking, there are two ways of calculating the amount universal service support that must be reconciled. Universal service support is generated by services whose prices are maintained above the cost-based levels that would persist in a competitive environment. Access charges, for example, have substantial levels of embedded contribution that presently supports universal service, but that contribution will be eliminated by the natural operation of competitive markets or regulatory mandates. The simplest measure of universal service support is the excess contribution embedded in the services that generate support. Another measure of universal service is the difference between the costs of providing supported services (*i.e.*, residential local telephone service) and the price of that service. The Commission has focused its efforts and analyses on the latter measure. A universal service program should be sufficient to replace the implicit support from the services that presently generate that support. In other words, irrespective of the costs of primary line, touch-tone residential telephone service, and irrespective of the benchmark(s), universal service support should be sufficient to generate revenues at least as large as the contribution generated by the services that presently provide universal service support. If interstate access charges now generate implicit support of \$6.3 billion annually –

¹⁹ See *In the Matter of Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, *Report to Congress*, FCC 98-67 (released April 10, 1998) ("USF Report to Congress"), Dissenting Statement of Commissioner Furchgott-Roth, at 3-4.

contribution that supports low local telephone rates – then federal universal service programs should also be designed to generate support equal to at least \$6.3 billion.

Fourth, the amount of universal service support developed by the Commission constrains its access reform efforts. If the Commission develops a universal service program of \$2 billion, then it cannot mandate access reductions greater than \$2 billion without running afoul of Constitutional requirements.

Fifth, in calculating the support received by supported services, the Federal plan must compare the costs of providing those services included within the definition of universal service with those revenues generated *only* by those same service. It is reasonable for the Federal plan to employ a benchmark, or benchmarks, as points of demarcation between what is supported by the Federal plan and what is supported by state universal service mechanisms. However, because the sum of state and Federal support must be sufficient, the form of these benchmarks should not be such that they discourage states from addressing their share of the universal service burden.²⁰

Sixth, any carrier, in order to be "eligible" for universal service support, must offer the supported services "throughout the service area for which the [eligibility] designation

²⁰ In particular, any benchmark cannot be based on the average revenue presently generated by all services. As competition develops, the prices, revenues and support provided by services like access and long distance should decline, so it is not sensible to use the pre-competition revenues of those services as the benchmark. In other words, the Federal plan may not, for example, inflate the benchmark by counting the very implicit subsidies that competition will eliminate and which Section 254 directs the Commission to replace with an explicit source of funding. As described below, the benchmark should be developed only after cost models are selected. It would be impossible to develop a "forward-looking" benchmark absent knowledge of the costs and restructured rates that form the basis of the benchmark.

is received."²¹ In other words, the Federal plan may not, for example, allow carriers to collect from the universal service fund without taking on the genuine burden of providing universal service to high-cost and low-income customers²² Likewise, ILECs may not be treated in a discriminatory fashion with respect to the manner in which they can recover the contributions that they make to the federal universal service fund. In other words, the Federal plan may not, for example, require ILECs to recover their contributions through increases in interstate access charges while permitting other eligible carriers flexibility in recovering their contributions.

Finally, an on-going universal service support mechanism should be designed to be administratively simple and accommodate the dynamics of a competitive market. GTE has long advocated a competitive bidding process whereby competing providers can bid for the level of universal service support. In its May Universal Service Order, the Commission indicated that it intended to release a Notice to develop an auction mechanism.²³ GTE urges the Commission to open such a proceeding promptly. An on-going universal service support program should rely on market forces and mechanisms, not regulation. Unfortunately, the Commission is mired in analyses of detailed cost

²¹ 47 U.S.C. § 214(e)(1); see Universal Service Order, ¶ 131.

²² As GTE has shown in its previous comments, the Federal plan as adopted in May creates opportunities for some carriers to serve selectively, by offering services which are attractive only to high-revenue customers, while still receiving support in the same manner as a carrier that provides an affordable service to any customer in an area.

²³ Universal Service Order, ¶ 325.

models, and developing social programs that promise to create greater regulatory oversight in a market that Congress intended to deregulate.²⁴

In short, to meet these criteria, the Federal plan must actually provide "specific, predictable and sufficient mechanisms ... to preserve and support universal service" and all telecommunications carriers must contribute to the fund established by the Federal plan "on an equitable and nondiscriminatory basis."²⁵

III. A FEDERAL FUND SHOULD BE CRAFTED TO ADVANCE FEDERAL UNIVERSAL SERVICE OBJECTIVES.

The 1996 Act is clear that the amount of support provided by state and Federal universal service mechanisms should be sufficient, but it does not specify what proportion of the necessary support should be supplied by the Federal plan.²⁶ Thus, different combinations of state and Federal funding could satisfy the Act's requirements. GTE submits that an estimate of the minimum size of the Federal plan can be arrived at by identifying those elements of the overall funding need which can reasonably be

²⁴ However, GTE also recognizes that, at the outset, an initial amount of Federal universal service support must be calculated, based on an estimate of the cost of service. The results of the auction process would then supercede this initial support amount in any area where an auction has been held.

²⁵ 47 U.S.C. § 254(d).

²⁶ This begs the question of who has responsibility for ensuring that the combined state and Federal support is sufficient, and what happens if the actions taken separately by state and Federal commissions do not produce the combined result Congress intended. GTE has argued that the FCC bears a plenary responsibility to ensure the overall achievement of the goals of the 1996 Act. The Commission itself has recognized, in its recent Report to Congress (at page 10) that it has "the ultimate responsibility" to ensure that 1) quality services are available at affordable rates; 2) rates are reasonably comparable; and 3) the combination of Federal and state mechanisms are "specific, predictable, and sufficient" to preserve and advance universal service.

accomplished only by the Federal plan. If these minimum needs are not met by the Federal plan, then the overall result will not be sufficient. By quantifying these needs, the Commission can create a yardstick against which the reasonableness of any Federal support calculation can be measured. GTE believes that there are at least three tasks which the Federal plan must be sufficient to accomplish:

First, the Federal plan must be large enough at least to replace the implicit support which is provided today by interstate access charges. As described above, implicit support is provided today by rates in both jurisdictions; when it is replaced by explicit support, the new funding would be applied toward offsetting reductions in the rates which are providing implicit support today. It is not reasonable to expect that a state commission would raise universal service funds within its own jurisdiction, and then use them to reduce interstate access rates. Thus, the interstate sources of implicit support can only be eliminated by the FCC, through the Federal plan. This simple fact places a floor under the size of the Federal plan that will be consistent with the requirements of the Act.

The Federal plan adopted in May ("May 1997 plan") is simply not adequate to do this job. GTE estimates that the amount of implicit support provided by interstate access rates today (excluding DEM weighting, and other forms of high-cost support) is about \$6.3 billion.²⁷ For GTE alone, the implicit support from interstate access is \$1.17

²⁷ GTE estimated the support implicit in interstate access by summing the switched access revenues of non-rural ILECs (exclusive of SLCs) from the most recent Tariff Review Plan ("TRP") reports, and then subtracting the revenue that would result from the same number of access minutes at a rate which covers the cost of access, including a reasonable contribution toward common costs.

billion. Said differently, interstate access rates already generate universal service support of at least \$6.3 billion, so it is disingenuous to assert that only a "small" universal service fund is necessary. The Commission already mandates a large universal service fund in the form of access charges maintained above competitively sustainable, cost-based levels. If the May 1997 plan is evaluated using the BCPM model and the common inputs requested by the Commission, the amount of high cost funding available to the non-rural companies is only \$1.096 billion. The universal service funding provided by the Federal plan would thus be far less than the amount needed to replace existing implicit interstate access support. The competition mandated by the Act will eliminate the \$6.3 billion of support now provided by access charges. Replacing the \$6.3 billion of contribution now provided by interstate access charges with a universal service program that generates only \$1.096 billion in support effectively shifts the economic burden of recovering the shortfall to states or will surely result in significant increases in local rates.

Second, the plan must strike a reasonable balance among the needs of the different states. Just as the Commission must address universal service in the context of eliminating implicit subsidies, state commissions must rebalance their rates as well, and shoulder the burden of costs that are unrecoverable in interstate rates. If the Commission were to defer the funding of all universal service needs to the states, then each state would have to find funding sources within its own borders to meet that challenge. However, some states which are relatively rural, and have relatively high costs, would have to address high funding needs, but would have relatively small revenue bases from which to generate the necessary support. Comments to the

Commission on its Report to Congress from many states have thoroughly documented this concern.²⁸ These comments show that in some high cost states, a very high surcharge would be needed to fund an adequate state universal service mechanism, and raise the concern that the national goal of service at affordable – and reasonably comparable --rates cannot be met purely through state funding mechanisms. The Federal fund can serve as a device for gathering the necessary support for these areas on a broader, national base.

On the other hand, if the Federal fund were to undertake all funding needs, states with relatively low costs and high revenue bases would be concerned that too much money would be collected from their customers, and transferred to customers in other states. The size and design of the Federal plan must be chosen to strike a reasonable balance among these concerns.

The May 1997 plan directs that all Federal funding should be used to replace implicit support from interstate access charges; it does not provide any funding to states to replace the implicit support that comes today from state rates for access, toll, vertical features, and other services. GTE agrees that Federal funding should be used to replace support from interstate access. As shown above, the amount of funding provided by the May 1997 plan is woefully inadequate for that purpose. Removing implicit support from access rates is the first step toward addressing the concerns of high cost states, since those states tend to rely on relatively high access rates as sources of implicit support. However, high-cost states may need additional Federal

²⁸ See, for example, Colorado at 2-3, Mississippi at 1-2, Alaska at 11, South Dakota at

support – over and above the amount required to eliminate the implicit support in interstate services – to avoid rate rebalancing that results in unrealistic, unsustainable or unaffordable rates.

The Commission must make an explicit policy decision regarding the amount of support it wishes to direct to the states. This amount should be chosen to strike a reasonable balance among the interests of the different states. Zero, the amount contained in the May 1997 plan, is not a reasonable balance. The Commission may wish to seek input from the Joint Board on this issue.²⁹ In addition to choosing the total amount of funding to be provided to the states, the Commission must also design the plan so that it distributes this funding to the states in a manner that corresponds to the relative needs of the different states. Once the amount of funding to be provided to each state has been determined, the plan should direct this amount to the state using the same procedure employed by the current Federal high cost fund: an offsetting allocation of cost to the interstate jurisdiction should be made through Part 36, Subpart F of the Commission's rules.

2, Wyoming at 1-4, Washington at 2.

²⁹ GTE recognizes that the Commission must move expeditiously to have a Federal plan in place by January 1, 1999, and that it may be difficult to complete a formal referral to the Joint Board within that time. It may be possible for the Commission to gather input through less formal means, such as *en banc* hearings and discussions among the Joint Board staff. GTE also points out that this concern over timing relates only to that portion of the new Federal funding which is to be passed through to the states. The other two uses of funding discussed here – replacing the implicit support in interstate access and maintaining current USF flows to the states – do not require Joint Board input.

A group of states, acting through an ad hoc work group at NARUC, have recently developed an alternative proposal for the calculation of Federal universal service support.³⁰ Under this proposal, *all* of the funding raised by the Federal mechanism would be provided to the states, and *none* would be used to offset interstate access rates. This approach is thus the mirror image of the May 1997 plan, which would use all of its funding to offset interstate access rates. In GTE's view, neither of these extremes is reasonable. In effect, since these two approaches address completely different objectives, they are not really substitutes for one another, but can more appropriately be viewed as additive. As discussed above, the Commission *must* adopt support sufficient to replace the implicit support in interstate access. If the Commission chooses to provide funding to states to offset intrastate sources of implicit support, this amount would then become an *additional* goal of the Federal plan. Any funding provided for this purpose would thus have to be *in addition* to the amount needed to address implicit support from interstate rates.

Third, the Federal plan should be a Pareto improvement – that is, designed to do no harm. The amount of funding provided to non-rural companies under the current high cost fund should be maintained. These amounts have already been reflected in the rates in effect in the states today. If this funding were to be withdrawn, as the May 1997 plan would do, states would be left with a shortfall which they would have to make

³⁰ High Cost Support: An Alternative Distribution Proposal, Prepared by the NARUC Ad Hoc Working Group on Funding for High Cost Areas (draft), submitted April 17, 1998.

up through some combination of rate increases and state universal service support.³¹

The new funding arrangements should leave the states at least as well off as they are today. The Commission has recently found, in its Report to Congress, that "no state should receive less Federal high cost assistance than it currently receives."³²

The amount of high cost funding provided to non-rural companies today is about \$219 million annually. Maintaining this flow of support is a third task which the Federal fund should accomplish *in addition to* the two objectives discussed above.

The total need for support from the Federal universal service mechanism is thus the sum of the amount needed to replace implicit support from interstate access (which GTE has estimated at \$6.3 billion) , the amount of new funding to be flowed to the states (to be determined as a policy choice by the Commission), and the amount of existing support that is flowing to the states today (about \$219 million).³³

It is important to emphasize that GTE is not advocating a make-whole universal service mechanism that will maintain ILEC revenues in perpetuity. The amount of universal service support that a carrier receives will ultimately depend on the number of

³¹ US West at Attachment 1; States Joint Comments at 3.

³² Report to Congress at para. 197. Note that, because the current USF is already reflected in state rates, this objective will not be met if all of the support provided by the new plan is used to offset interstate access rates. The new plan must therefore provide at least the current USF amount through Part 36, in addition to any amounts that are used to offset interstate access.

³³ This list covers only the amounts which should be provided by the Federal high cost mechanism for non-rural companies. It does not include support for rural companies, which the Commission has decided to continue on the existing basis for three years. Nor does it include the funding required for the Federal Lifeline and Linkup programs, or for the school and library fund. Similarly, it excludes DEM weighting, and Long Term Support.

customers it attracts and retains. The size of universal service funding, however, should start at a level at least as large as what is generated by current rate structures. A taking occurs if inadequate universal service support mechanisms are adopted and revenues from supporting services are reduced by regulatory fiat. Said differently, establishing universal service support should not be a covert rate case designed to reduce ILECs' earnings and revenues. Sufficient universal service funding would not create any windfall for ILECs, since every dollar of support, at the outset, would be offset by a reduction in rates. Nor would it serve to protect ILEC revenues from competition, since the support would be portable. What USF support *would* do is to change the transaction with which this revenue is associated. Today, ILECs recover through their access rates costs which are caused by the provision of local service. When GTE loses access minutes to competitors, or is obliged to reduce its access rates to meet competition, it will lose that revenue. If the same revenue is now replaced by explicit universal service funding (with a corresponding reduction in access rates), it will be associated with the provision of local service, where it belongs. GTE will lose that revenue if it loses local customers to new local service providers. Attaching the *revenue* that supports local service to the *provision* of local service in this way is vital if the correct price signals are to be sent to prospective entrants into the local market.

It is also important to emphasize that access charge reductions and reform are inexorably tied to universal service support. If the Commission adopts a Federal universal service support program that generates \$1.096 billion, it can reduce access charges by no more than \$1.096 billion. The Commission creates an unconstitutional taking if it chooses to adopt an inadequate universal service program and fails to create